MINUTES

BOARD OF TRUSTEES
PUBLIC EMPLOYEES' RETIREMENT FUND

143 West Market Street, Suite 602
Indianapolis, IN 46204

November 17, 1997
Annual Meeting

TRUSTEES PRESENT

Richard Doermer, Chair
Nancy Turner, Vice Chair
Dwayne Isaacs
Dr. Teresa Ghilarducci
Steven Miller

OTHERS PRESENT

Diana Hamilton, Special Liaison to the Governor for Public Finance
Richard Boggs, Burnley Associates
Kris Ford, Mercer Investment Consulting
Kellie Scheurell, Mercer Investment Consulting
Mary Beth Braitman, Ice Miller Donadio & Ryan
Donald Zakrowski, Coopers & Lybrand
Victoria Yamasaki, Coopers & Lybrand
Irwin Krueger
Garth Dickey, PERF Director
Patrick Lane, PERF Executive Assistant to the Director
Mark Webb, PERF Legal Counsel
Bill Hutchinson, PERF Division Director, Pension Administration
Michael Quigley, Program Director, Pension Administration
Linda Petro, Recording Secretary

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

A. Agenda of November 17 & 18, 1997 Meeting
B. Minutes of August 21 & 22, 1997 Meeting
   Minutes of September 12, 1997 Teleconference Meeting
C. Statements of Retired and Disabled Members - PERF, Judges' Retirement System, Conservation & Excise, and Police & Fire

A quorum being present, Chairman Doermer called the meeting to order.

1. INTRODUCTION OF NEW PERF GENERAL COUNSEL

Mark Webb was introduced as PERF's new General Counsel. Mr. Webb has been in private practice a little over nine years and spent the first six months of 1997 on loan in the House of Representatives representing the Democratic Caucus. Mr. Dickey noted that it was Mr. Webb's excellent performance while working with the Democratic Caucus that brought him to PERF's attention. "I think we're the beneficiaries of his desire to engage in public service."

2. APPROVAL OF MINUTES

Following review by the Board,

MOTION duly made by Nancy Turner, seconded by Steven Miller and unanimously carried to approve the Minutes of the August 21 & 22, 1997 meeting.

MOTION duly made by Dwayne Isaacs, seconded by Teresa Ghilarducci and unanimously carried to approve the Minutes of the September 12, 1997 teleconference meeting.

3. ELECTION OF OFFICERS

Following some discussion,

MOTION duly made by Dwayne Isaacs, seconded by Teresa Ghilarducci and unanimously carried to retain the officers as previously elected as follows:

Richard Doermer - Chair
Nancy Turner - Vice Chair

4. HONORARY DIRECTORSHIP

Chairman Doermer noted for the record that he is an Honorary Director of NBD Bank of Indiana. That's not the parent company but the Indiana subsidiary. He used to be an active Director but is now Honorary, and while he is paid, he has no authority to cast votes. In the past, when NBD was a topic of conversation at the PERF Board meetings, Mr. Doermer removed himself from the discussion and/or vote

Mr. Dickey added that in the two years he had been at PERF, when there was consideration given to custodial assignments, it was always Chairman Doermer's practice to remind people of his own connection to NBD historically and recuse himself from a vote. "That's not to say that you need to recuse yourself under the policy going forward as a matter of both appearance and your own conscience. Your disclosure in the past and today are appreciated."

5. OUTSIDE EVALUATION OF INVESTMENT ACCOUNTING CONTROLS & STAFFING ADEQUACY

Mr. Dickey noted that PERF had been given an exemption from the current Broad Agency Announcement ("BAA") rules to issue a Request for Proposal ("RFP") to seven different accounting firms for the purpose of conducting an outside evaluation of investment accounting controls and staffing adequacy. Coopers and Lybrand was the firm selected to conduct the audit.

Victoria Yamasaki and Donald Zakrowski were present representing Coopers & Lybrand. Ms. Yamasaki explained that as she and Don sat down with Mr. Dickey and Patrick Lane, they were able to develop a good understanding of what the Board and Mr. Dickey were looking for in terms of documenting the existing controls in the investment operations. They have experience with other public pension funds of a similar nature and scope of this project, and they intend to use their experience from those projects to indicate where PERF may have some overlapping controls as well as areas where there are gaps which need some controls. From all of that, they are going to formulate a manual of written policies and procedures which will be a road map for the investment group to manage these operations going forward. They will be assessing the capability of the investment operation, both administratively and operationally. They will also analyze the staffing needs of not just the investment functions, but provide some assistance and analysis on the organizational structure and the operational hierarchy of the entire organization because there have been some concerns expressed about where the Fund stands against some of the other public and private pension funds within the industry.

Some of the issues to be looked at are the Fund's information requirements — are you getting the right type of information, do you feel that it's too much, that it's too little, is it timely, is there a different set of information that would help manage the fiduciary responsibilities? Coopers also wants to benchmark against other organizations to see how PERF stacks up, especially in light of the movement into an equities-based portfolio. Clearly, that presents a different set of risks and challenges. Coopers is going to evaluate, in the context of the investment process, the stress points or pressure points within the organization where there could potentially be fraudulent activity. In the context of the entire interview process, they will be looking at the user controls that are recommended for the Statement of Auditing Standards #70. This is a public document which relates to internal control processes that exist to insure that transactions are recorded properly, that they are processed timely, and that there is a system in place to make sure that everything is complete and accurate. Lastly, Coopers will evaluate the competency in training, the tools the employees' need to conduct their responsibilities on an on-going basis. In their final report to the Board, they hope to segregate their findings and recommendations by those that present immediate short-term opportunities for improvement as opposed to long-term opportunities for improvement. They will document the existing controls, provide a formal policies and procedures manual, and provide recommendations to the organizational structure as well as recommendations on staffing requirements.

Chairman Doermer observed that the Board has historically given much greater attention to the investment process and performance, and there is not a total sense of comfort about the administrative side. The level of service is something sort of murky, and the adequacy of the staffing needs to be addressed. "When you come up with suggested reports, will they be such that we will be able to, in looking at our own fiduciary obligations here, have some sense of the administrative function and the level of services provided by the agency?" Ms. Yamasaki responded that Coopers' primary focus will be on the investment operation; however, as relates to the operational hierarchy and the staffing requirements of the entire organization, they will provide a much needed bench marking analysis.

Chairman Doermer continued that Coopers' presentation seemed to offer an alternate fee for a more comprehensive manual. "Has that been resolved?" Mr. Dickey responded that the word "manual" turned out to be a very charged word and had a very high charge associated with it as well. Thus, it was requested that Coopers give the Fund something more than an outline but less than an exhaustive, detailed report.

> What we are looking for is something that lays out things which should be done. Once we have that blueprint, if we feel the need to ask for additional work to get it flushed out, we can always go back. But, we are hoping that what we get is going to be perfectly obvious to all of us, and we can work from that and create any additional detail that we need.

Ms. Ghilarducci inquired concerning the time frame for completion of the project (the end of December). "How does this time frame compare to the other audits that you've done, and do you have any reservations about how well you can do the job because you're doing it so fast, or is it so fast?" Ms. Yamasaki responded that it varies depending upon how much cooperation they receive from an organization in terms of gathering shelf materials, getting the information very quickly to Coopers, setting up interviews, etc. In the case of PERF, it is very doable with the cooperation received thus far and will not press Coopers so that PERF will not get the value they should receive. Mr. Zakrowski added that the only potential kink in the hardware is the other bench marking studies and how timely they receive that information. However, if it did appear that this would present a problem, they could still present the first part of the report and then do the bench marking afterwards.

6. DISCUSSION OF INTERVIEWS WITH EXISTING MONEY MANAGERS

The following firms met with Richard Boggs and Garth Dickey on November 17 to discuss their portfolio performance:

> Danson & Neuhar
> HM Capital Management
> Holland Capital Management
> Pacific Income Advisers

Mr. Dickey reported that the meetings were good; however, there were not uniformly good results. Mr. Boggs added that three of the managers (Danson, HM, and Holland) are all currently running 50/50 portfolios. In that the 50/50 is being abolished and everyone will be moved into a LBA type strategy, a bulk of the discussion was spent not on what they did right or wrong in the 50/50 sector, but how they were going to handle the transition to a LBA portfolio and whether that would make any change in the way they invest money compared to the way they invest other kinds of funds. Each of the managers felt it was not a major obstacle.

Mr. Dickey offered observations on two of the managers. HM Capital is a very unusual manager in that they are completely in governments. Despite the fact that they are managing against the Lehman Brothers Aggregate, they have chosen not to hold any mortgages, corporates, or agencies. They like to play duration, and PERF's new guidelines provide a band of duration plus or minus 20% of the index duration. HM actually expressed that they like it better when they are given a fixed number duration in years so that they can go from 3 years out to 8 years, for example. Mr. Boggs and Mr. Dickey challenged them on that and inquired if they would really ever want to move more than 20% of the index plus or minus. They said "probably not", but the answer seemed to be that they would like to.

The problem is that HM has been guessing wrong. When they were asked where they would like to be, they indicated they would, in fact, like to be even shorter. They were then asked how they could expect rates to be going up when rates are already at historically high levels when you look at real long term rates. They answered that they look closely at the monetary impact of external foreign government central bank purchases of U. S. governments, and they believe that foreign governments buying so much of U. S. government is pushing inflation up. Mr. Boggs added that by staying 100% in treasuries, they ignored the fact that yield spreads narrowed in corporates and mortgage backs, so they missed the boat in that respect as well.

Mr. Dickey continued that the manager who was quite striking was Pacific Income. They have a relatively unusual philosophical framework. As a fixed income manager, their entire approach is based on the idea that the yield curve has a natural sort of upward slope and that when you see yield curves getting too steep, they will eventually get back to normal or when the yield curve is getting too flat, they will go back to normal. Based on their academic work and their experience and focus on that approach, their performance has been exemplary.

Concerning the other two managers interviewed, Danson & Neuhar has done a nice job. They gave a much more cogent explanation than HM. Their approach is perhaps a little more traditional in terms of a top down sector weighting — they are trying to overweight different sectors. They are cognizant of the benefit that "BBB's" can bring, but right now they wouldn't want to jump into "BBB's" because they think spreads are relatively low. They had a solid performance and will always be duration neutral, so they won't add a lot of value, but they'll never lag a lot either because they do it all by sectors. They are more likely to play in the sectors and asset classes. They do have a pretty good track record and seem to have a good grasp of multi tranche CMO's and some asset back structures.

The last manager interviewed was Holland Capital Management. Lou Holland has been a manager for PERF since 1994. He is an emerging minority manager with a long history as a money manager and stock broker. Unfortunately, some of his performance numbers were not as good as you would like to see. They typically carry durations reasonably close to the index, and they don't overweight or underweight anything very dramatically.

In his presentation, Mr. Holland focused on the fact that as an active fixed income manager, they try to add value by being defensive in a down market. It has been hard to outperform the index; however, they think they will add value because their cautious, conservative approach will help them outperform the index in the long run.

Chairman Doermer inquired if either Mr. Boggs or Mr. Dickey had any particular recommendations to the Board with respect to any of the four managers interviewed. Mr. Boggs responded that their feeling was that on all of the managers, when you look strictly at performance, nothing needs to be done at this point. The Board could wait another 1-2 quarters and get more data on some of the managers.

Mr. Miller inquired if any of the managers were concerned about the reallocation to equities and how it is going to affect them. Mr. Boggs responded that they know — the Board has been very forthright in telling them that there are currently 15 active bond managers, and a year from now there will probably not be 15 managers. Mr. Dickey added that the Board has been open with the managers and stressed to them to do a good job. Things will change down the road, but no one seems to be taking any inordinate risks in anticipation of those changes.

Mr. Dickey reported that there was another situation about which the Board should be informed. WR Lazard has lost their former CEO. There has been a history of turmoil. Assurances were given last year that the new CEO was going to get everything under control and had new capitalization lined up and that everything would be fine. Then she suddenly announced three months ago that she was leaving due to a disagreement with the largest shareholder (Betty Lazard). Jonathan Carroll, President of Carroll & Company Capital Management, has now come onto the scene to recapitalize the company. There have been a number of major losses of business by WR Lazard. The cities of New York, Baltimore, and Los Angeles have terminated them as well as Consolidated Edison. They are now something under $200 million — the total terminated was over $1.2 billion. Mr. Carroll, along with Bill Schultz, Portfolio Manager, subsequently met with Mr. Dickey and were asked the status of the firm. They indicated the outlook was good. Mr. Carroll was going to be putting in $1 million and creating a new structure. He indicated that rather than put money into the existing company for a host of what he explained were mostly technical reasons, he wanted to buy certain assets from the existing company, including the managers, and create a new company. Mr. Dickey noted that the major concern here is the viability of the ongoing entity. They have lost a critical mass of clients. PERF's dollars are not substantively at risk because they are all with the custodian. The real risk is whether they take their eye off the ball and their performance falls apart. When they have lost more than three quarters of their business, how much attention can they continue to bring to what remains? Steve Miller, Dwayne Isaacs and Mr. Dickey had discussed this issue at the last meeting of the Investment Committee because all these events were hot at the time. They felt that no precipitous action should be taken but that it should be brought to the attention of the Board. It was the Investment Committee's feeling, however, that the firm should be terminated. Thus, it was Mr. Dickey's recommendation, and following some discussion by the Board:

MOTION duly made by Steve Miller, seconded by Dwayne Isaacs and unanimously carried to terminate WR Lazard's relationship as a manager of the PERF portfolio.

7. LONG TERM REALLOCATION TRANSITION PLAN

For discussion purposes only, Mr. Boggs explained that at the most recent Investment Committee meeting, money manager realignments were proposed as follows (in millions of dollars):

Fixed Income

LBA Index - Passive		
Manager 1	$1,400	20%
LBA Index - Active		
Manager 1	200	3%
Manager 2	200	3%
Manager 3	200	3%
Manager 4	200	3%
Manager 5	200	3%
Mortgage Backed Specialist		
Manager 1	100	1-1/2%
Asset Backed Specialist (Maybe)		
Manager 1	100	1-1/2%
Corporate Specialist		
Manager 1	100	1-1/2%
Manager 2	100	1-1/2%
TOTAL FIXED INCOME	**$2,800**	**40%**

Equities

Large Cap - Passive		
Manager 1	600	9%
Large Cap - Enhanced		
Manager 1	300	4%
Manager 2	300	4%

Large Cap - Growth		
Manager 1	315	4-1/2%
Manager 2	315	4-1/2%
Large Cap - Value		
Manager 1	315	4-1/2%
Manager 2	315	4-1/2%
Equity Large Cap	**$2,460**	**35%**
Mid-Cap - Growth		
Manager 1	280	4%
Mid-Cap - Value		
Manager 1	280	4%
Small Cap - Passive Index		
Manager 1	245	3-1/2%
Small Cap - Enhanced Index		
Manager 1	245	3-1/2%
Equity Mid/Small Cap	**$1,050**	**15%**
International - Passive Index		
Manager 1	350	5%
International - Active		
Manager 1	175	2-1/2%
Manager 2	175	2-1/2%
Equity International	**700**	**10%**
TOTAL EQUITIES $4,210	**60%**	

Chairman Doermer inquired if there were significant fee differences between enhanced index and passive index managers. Mr. Boggs responded affirmatively.

> Right now with American National Bank you're looking incrementally at 1 basis point for every new dollar that goes into the index. When you go to enhanced, you will see an increase there of 5-10 basis points, but you're also looking not at tying the index but at the reasonable expectation that you're going to beat it by 50-100 basis points.

Chairman Doermer inquired further if it was reasonable to anticipate that better performance could be gained from an active equity manager as against benchmark than an active fixed income manager. “Our fixed income managers have not performed all that well. Do we have reasonable expectations for something better from the equity managers?” Mr. Boggs responded that over most periods of time, the index will always be roughly in the top half, probably not quite the top third of all managers. That’s true of bonds as well as stocks. It is also true, because of the nature of the asset classes, that bonds will work plus or minus around a narrower band around the index than stock managers will work. Stock managers have more opportunity to succeed and/or fail than do bond managers. As a rule of thumb, you can use plus or minus 50 basis points for bond managers and 100-150 basis points as a reasonable expectation for stock managers. The only rationale for an active manager is that you have the expectation, net of fees, that he is going to beat the index. Otherwise, a fund should index 100%. So the consultants and the Board collectively will need to select from among that 1/3 to 1/2 of the managers who can be expected to beat the index.

8. RECESS

Following some further discussion, the Board recessed the meeting, to be reconvened at 8:30 on November 18.

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Dwayne Isaacs
Dr. Teresa Ghilarducci
Steven Miller

OTHERS PRESENT

Diana Hamilton, Special Liaison to the Governor for Public Finance
Richard Boggs, Burnley Associates
Kris Ford, Mercer Investment Consulting
Kellie Scheurell, Mercer Investment Consulting
Mary Beth Braitman, Ice Miller Donadio & Ryan
Donald Zakrowski, Coopers & Lybrand
Victoria Yamasaki, Coopers & Lybrand
Doug Todd, McCready & Keene
Joe Thomas, McCready & Keene
Leland Tanner, Prime Capital Management
David Withrow, Prime Capital Management
Stephen Tufts, Prime Capital Management
Philip Barnes, Prime Capital Management
Suellen Jackson-Boner, Governor's Planning Council for People with Disabilities
Irwin Krueger
Garth Dickey, PERF Director
Patrick Lane, PERF Executive Assistant to the Director
Mark Webb, PERF Legal Counsel
Bill Hutchinson, PERF Division Director, Pension Administration
Diann Clift, PERF Management Information System Director
Michael Quigley, Program Director, Pension Administration
Dave Yeater, PERF Controller
Linda Petro, Recording Secretary

A quorum being present, the meeting was called to order.

1. INVESTMENTS

Mr. Boggs reported that during the third quarter the bond market was up 3.3%, with longer bonds doing better than shorter bonds. When looking at issues of similar duration, mortgages did better then agencies of the same duration, and corporates and mortgages did better than treasuries of the same duration.

As the Fund has placed $100 million per month into the equity market, the value added has been about 30 basis points during the quarter. Also, the bond managers collectively were overweighted in corporates which helped. The duration of combined bond managers was about the same as the LBA.

Virtually all of the 50/50 managers are now in transition toward an LBA. While their actual performance will be carried for the purpose of making the total equal the sum of the parts, for judgmental purposes they will be judged on their composite for other LBA clients until they have fully implemented an LBA-oriented portfolio. Thus, they will not be penalized or unnecessarily benefitted by being lucky during the transition. Their estimate is that it will take a couple of weeks to make the transition.

There were no surprises with respect to securities lending. The mismatch and maturity were all within conformance of the guidelines. The securities lending income is more than covering the custodian fees. It's not quite covering the manager fees but is within striking distance.

Concerning cash flow,

MOTION duly made by Steve Miller, seconded by Dwayne Isaacs and unanimously carried that all funds going in and out for the 1st quarter of 1998 be directed through the Reallocation Fund.

Additionally, Mr. Dickey indicated that his initial thought was to move all the WR Lazard funds into the Reallocation Fund. However, for a host of reasons, it would be better to recognize the fact that WR Lazard, while not an emerging minority manager, was still one of the Fund's minority managers. Thus, he suggested that a portion of Lazard's $73 million be given to an existing minority manager with the idea that it would be showing a good faith effort to keep money with minority managers.

Ms. Ghilarducci added that she would like to recognize that such a move would also be for reasons beyond good will. New managers have a disadvantage because economies of scale really matter. Also, a track record matters so that when you have a big firm like Prime Capital Management who is doing so poorly, you can look at the facts that they have a ten year history and low fees. That's because they've been there. It actually may be very smart for a fund to have more than an optimal number of managers and to pick small firms because the Fund can get an advantage of having some foresight based on a little bit of experience. A smaller firm is hungry and innovative and needs to prove themselves, and PERF could benefit by really paying attention to the strategic advantages of giving more money to a smaller firm. Following some further discussion,

MOTION duly made by Teresa Ghilarducci, seconded by Nancy Turner and unanimously carried to allocate an additional $30 million to Hughes Capital Management and the remaining $43 million to the Reallocation Fund.

Prime Capital Management

Leland Tanner, Philip Barnes, David Withrow, and Stephen Tufts were in attendance representing Prime Capital Management.

Mr. Tanner began that portfolio duration was about 5.09 years or 110% of the LBA Index at the end of the third quarter. That was only a very small change from the preceding quarter which was 5.11 years or 111% of the LBA Index. Some changes were made by Prime during the quarter. They analyzed historical total rates of return of 30 year treasuries versus 20 year treasuries and found that the 20 year treasuries returned almost as much as the 30 years over time with less risk. Thus, they sold out their 30 year treasuries at a cash profit of $386,000 and reinvested. They also continue to add finance bonds to their holdings. Their big change was made prior to June 30 and after May 31. Earlier in the year they had been a little defensive and were afraid that the Fed was going to raise rates. They were too defensive, so in May they took a more neutral position, and at the end of June they were long duration. At the end of May they had 17% cash, and on June 30 that was down to 1%. That investment was made basically in 5 year treasuries and a little addition to the 10-30 year treasury sector. That's what extended them out and prepared them for what proved to be a good last quarter. At the end of the quarter, they still have 2% in money market, 44% in treasuries, 28% in mortgage backs, and 26% in finance. That is basically unchanged from the previous quarter with the exception of the increase in finance holdings by about 10%.

Looking at the PERF portfolio compared to the LBA Index, under 1 year neither the index nor the PERF portfolio had much cash. In the 1-3 years, the index had 32% and the portfolio had 11%, so there was an under weighting of 21% in that particular category. There was an over weighting in the 3-5 year category by 17% and an over weighting in 10-20 year category by 16%. That's where Prime made their portfolio bets. In the sectors they were equally weighted in money market, treasuries, and mortgage backs and had an over weighting in finance and an under weighting in other types of bonds. The under weighting was basically in Yankees, utilities, and industrials, etc. The reason they chose to invest in finance as opposed to the other bonds is that they provide a better protection and are non-callable. They had a good spread over treasuries, and Prime felt much more secure with the finance than the other options they had.

Looking at changes made in the portfolio during the last month, the PERF portfolio versus the LBA at the end of October was still overweighted in the 20 years, overweighted in 3-5 years, and under weighted in 1-3 years. Again, Prime increased their overweight in finance a little, and they are going to continue to do so because they feel that's where the actual value lies. The yield curve during this particular period of time was very good. The long bond declined quite a bit from June 30 — it was down 62 basis points in a four month period. The 5 year also declined 65 basis points. By Prime being longer in duration during that time, they had a very good quarter. Again, while the quarter was better than the index by about 20-25 basis points, Prime outperformed the index by another 20 basis points during the month of October. Thus, they feel that they now have a handle on things and look forward to closing out the year on a high note.

Volatility is something to be expected in the stock market. A 1% swing in the stock market is 75-80 Dow Jones industrial points, and that's been rather common. However, until recently a 1% movement in the bond market has been the exception rather than the rule. Since July 1st there has been a lot of volatility in bonds. There were 90 trading days the four month period of June 30 through October 31. On 32 days, or 35% of that time, the market had intra-day moves of 1 point or more. On 18 of those days, there were close-to-close moves of 1 point or more, or 20% of the time one day's movement was over 1 point. There seems to be no concrete answer for this movement, but whatever the reason, it has been nerve racking, especially at the end of the month through the end of the quarter. There have been big moves at the end of a quarter wherein coming into a quarter you look like you're doing pretty well, and on the last few days of the month you have a 2 point move up or down. Depending on the position in which you have been, what could have been a good month all of a sudden turns into a not so good month.

Looking forward, Prime believes that the economy will continue a slow growth, inflation will remain well controlled, and that long bonds will trade in the range of 6% to 6-1/2% or lower. Because of that, their portfolios will maintain durations of 110% to 115% of the LBA Index. They are now looking at possibly adding a few 10 year corporates. Last month the corporate bond market for the first time in about a year did see widening in spreads. Prime has had no transactions this last month, and they plan to continue to hold their course.

Mr. Dickey inquired as to the manner in which Prime is running the Reallocation Fund. Mr. Withrow responded that including the initial investment of $300 million (which came out of the LBA -5 portfolio in May), to date, including the November transfer, there has been $900 million invested. Currently, there is enough remaining in the LBA -5 portfolio to fund the December transfer and a large portion of the January transfer. Prime has already begun the process of liquidating the 50/50 Index. There have been favorable markets up to this points, and with market values up, they have taken advantage of that to get the most bang for the buck without taking undue risk. It looks pro forma now as though they will have sufficient money in the 50/50 to cover transfers in February, March, April, and enough for a portion of the May transfer (approximately $80 million). Some of that depends on where the allocations come from for new inflows into PERF and outflows out of PERF. However, generally speaking, there will be sufficient funds to make the February through May transfers. Mr. Dickey noted that with the recent action taken by the Board to terminate the services of WR Lazard, there will be another $43 million transferred to Prime for the 50/50 Fund. It is intended to supplement the Reallocation Fund and should provide the monies needed for all transfers through May.

2. <u>McCREADY & KEENE PRESENTATION</u>

Doug Todd and Joe Thomas were in attendance representing McCready & Keene.

Mr. Dickey noted that the actuaries were present at today's meeting to give a brief recap of where the Fund stands, of what projects are underway, etc. Mr. Todd began that the project on which he has spent the most time recently is the fiscal impact of some various proposed changes to the Police & Fire pension plans. Now with the investment in equities, the interest rate can be increased for the funding of the plan, and that's brought about some possibilities of perhaps lowering the retirement age. There's even been a suggestion of moving some liabilities from the converted plan members over to the 1977 Fund. The converted plan members are now a financial responsibility of the cities and towns. This would move it over to the 1977 Fund and relieve some of the pressure on the cities and towns.

Concerning actuarial valuations, there are six plans for which they do annual valuations to determine the funded status of each plan and to determine the funding levels for each plan. They continue to recommend a employer contribution rate of 21% for the 1977 Police & Fire plan. McCready is currently working on the other five plans and hope to be able to make a formal presentation of those reports to the Board at its next scheduled meeting in February.

There was a recent change in the law with respect to the Pension Relief Fund. There is now the requirement of an annual report to the cities and towns on projected benefits under the old plan and converted members of the 1977 Fund. McCready is almost finished with that report.

With respect to fiscal analysis of various proposed legislation, McCready is already receiving requests for fiscal statements from the Legislative Services Agency. Mr. Dickey interjected that as the Legislature begins, there will be bills introduced. It is PERF's obligation to monitor closely any introduced legislation or contemplated legislation that will have an impact on any of its six plans. Rarely is there any advocacy position taken — there are a few minor legislative items of a corrective or clarifying nature. Those will be addressed during the Board's next meeting. But, by in large, PERF's role is an evaluative one so that they are asked to contribute (working with the actuaries to contribute) a fiscal impact study on any proposed legislation that will have an impact whether it's increasing benefits, changing a benefit structure, etc. It's up to PERF to come through with a fiscal impact study that lets the Legislature be fully armed and understand the financial consequences of making those changes.

Additionally, McCready is also conducting an actuarial experience study for Police & Fire. When an actuarial valuation is prepared, certain assumptions are made (i.e. the frequency of terminations, deaths, retirements, salary increases, etc.). An experience study looks at whether a plan's experience agrees with what has been assumed. There is a requirement that such a study be completed every five years for PERF. The last one completed for the Police & Fire Fund was in 1977. That is due in part to the fact that when the employer rate was established at 21%, it stayed remarkably level over all these almost 20 years. Nonetheless, it is a good time to do an analysis of the experience.

Currently, all of the rate setting and valuation is based on certain modeled assumptions. One example of where actual experience will be considered is whether, in fact, people retire as soon as they can. It is built into the model currently that people will retire in the police and fire world at age 55 with 20 years of service. The fact is that one need not retire from these departments at age 55 — one can continue to accrue additional service, and additional benefits accordingly, by working on to age 57, 60, whatever. The question then is what do they do, and the other question is whether what they really do has a financial consequence as opposed to what has been modeled. This experience study should be completed and ready for presentation to the Board along with the 1998 valuation reports next spring.

3. UPDATE ON INVESTMENTS MADE SINCE LAST MEETING

Mr. Dickey apprized the Board of the fact that investments of $100 million per month have continued to be made. Wherever possible, it is trying to be done with the lowest possible transaction costs, utilizing crossing opportunities wherever possible. The Board had previously directed the use of futures on those transactions. The contract for that is still in the works. There are no problems, but with everything else going on, it has not yet been implemented. To date, there has been $900 million moved over into the ANB S&P 500 Index Fund at an average cost of something around $0.015 a share.

4. BROAD AGENCY ANNOUNCEMENT

The Broad Agency Announcement ("BAA") has been posted to the Department of Administration's ("DOA") Procurement web site and will also be advertised in the Pensions & Investment ("P&I") magazine next week. This is one BAA with four components looking for proposals for large cap passive indexing, large cap enhanced indexing, small cap indexing, and small cap enhanced indexing. Mr. Dickey noted he would be surprised if anyone proposed what would be a pure small cap passive index because the indexes are too large and it just is not economical to do a full replication. But for symmetry, it was felt that proposals should be requested at any of the four levels. The Fund is not obligated to take any action on any proposal.

Proposals were mailed yesterday and today to a list of managers who have either recently (i.e. in the last six months) requested to be copied on BAA's, or they are among lists that have been provided by both Burnley Associates and Mercer Investment of money managers they wanted to make sure were included. There are over 70 firms to which proposals were mailed. It was made a part of the P&I ad that no manager wishing to respond to the BAA should have any direct contact with PERF or the Trustees. Under the procurement rules of the State, all contact with the agency has to cease during the period of the BAA. A firm runs the risk of being disqualified should they do so. All contact will be focused through the Procurement Department. This is an effort to channel and document the contact. So what happens is that all prospective bidders under the BAA are asked to send written questions which they have with respect to the BAA to the Department of Administration. Those questions will be collected by DOA and would normally be sent to the agency for response. In the interest of efficiency and trying to cope with the level of questioning that may be received, DOA will be channeling those questions to PERF as they receive them. There is a cutoff period for receipt of those questions, and PERF will then have as long as they need to consolidate those questions and respond in writing. The responses go to all firms who have requested a copy of the BAA so that everybody is on a level playing field. By December 19, all bids must be received by 2:00 p.m. at the Department of Administration. Once received, PERF will examine the physical documents. Most of the questionnaire details are information about people's performance and about their firms. That information, wherever possible, will be received on disk and will be turned over to PERF's consultants to help sort through the number and performance statistics. Hopefully then in January, the Investment Committee will be able to look at the results. The time line is aggressive, but it's only as aggressive as the Board wants it to be. They control the process, and they have the option to slow things down if additional time is needed for analyzation. The purpose is to choose the best managers in a fair manner.

Chairman Doermer inquired with respect to the scoring system. Mr. Dickey responded that the scoring system is in some respects mandated by the rules. In a simple approach, it's required that 20% of any scoring be allocated to price at a minimum and that 5% be allocated to minority business enterprise. The PERF staff has worked with DOA to draft what is sufficient flexibility to give a ranking that will work fairly. There is a 30% weighting for relevant experience, 30% for performance, 15% for the stability of the organization, 10% for assets under management, 10% for cost, and 5% for minority business enterprise. There has been an effort to accommodate the State's requirements while at the same time injecting sufficient flexibility and recognition of the overwhelming need for competent organizations with good performance. There should be plenty of room to come up with a fair and balanced evaluation without the structural constraints of the process getting in the way of good judgment.

5. <u>PROGRESS OF A UNITIZED TRUST ACCOUNTING SYSTEM</u>

At the Board's last meeting, authorization was given to the Director to move forward with negotiations with the existing custodians for a unitized trust accounting system. Both custodians have been quite cooperative. At the same time, in the case of National City Bank, after many weeks of assurance that there would be no problem, about a month ago they informed PERF that they could accommodate the request, but they cannot do it themselves and it will cost PERF a whole lot more money. The problem lies in the daily valuations which are an essential part of the unit trust accounting. PERF is paying benefits on each of these funds and needs to be able to account for that on a daily cash flow, in's and out's, basis. There are no changes with respect to the bulk of the assets. It's not that there are huge changes in the portfolio — it's the incremental changes around the edge that become the issue of daily valuation. National City is unable to do that by themselves. They have talked to a number of different vendors at PERF's direction and came back with a recommendation that SEI, one of the dominant forces in trust accounting software, provide this service. Rather than the original numbers of between $400,000 to $2.2 million of additional cost per year, they have said they will do all this for either a 0.15 of a basis point increase in the custody fee or a one time charge of $200,000. Mr. Dickey noted that it would be his choice to go with the $200,000 because the value of that annuity is far greater than the one time charge. He is currently looking at the existing contract and contractual amendments and exploring how clearance can be obtained through the Department of Administration to provide this payment of the initial $200,000. This has delayed the process in terms of its actual implementation. However, he still feels it is something that can be done. Under the existing law an "Indiana bank" has to be used, and National City was selected through a BAA. "I certainly don't want to undertake a whole new BAA at this point to find a new custodian when I don't believe the universe extends any further than Bank One and National City. Between the two, National City is the better of the choices."

Chairman Doermer requested that Mr. Dickey detail what is achieved by the unitized trust accounting system. Mr. Dickey responded that the biggest benefit it will provide is uniformity of results across all the funds administered by PERF. For example, the Police & Fire Fund is a $1.5 billion fund. None of those monies have been moved into ANB. All of the money that has been moved is PERF money. By moving to unit trust accounting, prospectively and retroactively, a common performance will be shared of all the funds managed, all in accordance with the same set of guidelines, and there will be an essentially common performance across all of those funds.

6. INVESTMENT MANAGERS' RESPONSES AND COMMENTS ON NEW INVESTMENT POLICY

Nothing was been brought to light that was significantly amiss with the new investment policies. By in large, all of the money managers were relatively comfortable with the policies. They did have two areas of general comments. On the insurance side, there were a variety of responses ranging from "We don't have any, and it will cost us money to add it" to "Yes, we have E&O insurance, but we don't have fiduciary insurance. We have an ERISA policy — is that what you want?" They all know that what the Board is trying to do is not to penalize them but rather that the Trustees want what others have.

In the case of Prime Capital Management, with PERF as their dominant client, they have never been required to have the insurance. If it is required, there will be an incremental cost to them. The Board's policy currently calls for them to have this kind of insurance. One estimate out of the box would be an incremental cost to Prime of $42,000 a year. There is a two-edged sword involved here. On the one hand, it is not clear what the Fund would get by requiring this of Prime with which they have not already been comfortable. On the other hand, Prime should not be treated significantly at variance from how others are treated. Mr. Dickey suggested that he could extend the implementation, with the Board's comfort, by another three months thereby giving him time to work out the correct language. Based on his experience with the other managers, he is finding out that quite a number of them have for their ERISA clients some form of ERISA fidelity bond or ERISA E&O policy to the extent that that would provide something that would be uniform for all the managers. Mr. Dickey will work with all the managers over the next three months and report back to the Trustees at the next meeting in February. Hopefully, by then he will have a detailed report on what people have and recommendations of specific language for incorporation in the Investment Policy of what seems to be a uniform practice in the industry and would, in fact, be uniform for all of PERF's managers.

Additionally, the main area of interpretative need voiced by the managers concerned the Board's effort to create continuity between the benchmark set for a manager and the discretion to invest in securities in that benchmark. The guidelines were defined as being the securities that are in the index. There were a variety of comments there with respect to the fixed income index that is being used. It is a technical reality that the Lehman Brothers Aggregate, PERF's index of choice, does not include CMO's. The bulk of CMO's are a security that is created from existing mortgage backed securities, so it's a reconfiguration of existing mortgage backed securities that are included in the index. To avoid double counting those same assets when they are sliced, diced, and mixed as CMO's, CMO's are excluded from the index. The language of the new guidelines is sufficiently broad to give comfort to including CMO's. The interpretation Mr. Dickey is taking with managers in trying to be consistent in responding to their inquiries is that CMO's are permitted. So, there is some fine tuning that may need to be considered down the road in terms of the guidelines, but basically a lot of it is interpretative.

7. LEGISLATIVE CHANGES

Mr. Dickey noted for the Board's attention that the State Treasurer has announced her intention to have legislation introduced during the next session to place the investment activities of both PERF and the Teachers' Retirement Fund under the Treasurer's control. In all probability the legislation will not move forward, nor will it necessarily come out of committee should it even be introduced. In a comment made to the Indianapolis Star, Mr. Dickey noted that the Board is an extremely non-partisan and fiduciarly focused board and he would be disappointed if the Legislature felt the need to change that. Should any of the Trustees be asked; however, he wanted them to be aware of the fact that this is an issue, at least for the Treasurer. The Governor's Office and the Republican leadership and the Finance Chairman of the Senate were directly quoted as saying that they thought this was a fairly ambitious plan.

8. BOARD OF TRUSTEES' EDUCATIONAL RETREAT

This was made an agenda item because over the course of the last year, as the Board has been grappling with a host of issues, there have been numerous occasions where something has been identified that they would like to look at down the road. With that in mind, the floor was opened for discussion of the desirability of considering an educational retreat. There would be fine lines to be walked because there would clearly be a Board meeting conducted. However, it could be a Board meeting without any intention of action but rather simply of learning and of addressing a particular agenda of topics. It could be a meeting at a more conducive location than the PERF offices where the Board could get away from telephones or at least have a chance to spend some time in depth. It also could be a meeting or series of meetings where guest speakers would be brought in to address whatever topic the Board felt necessary. That's not to say there will be no educational content in Board meetings — that has to be done as an ongoing matter.

Mr. Miller inquired if such a session would include looking at the administrative side of the Fund as well as the investment. Mr. Dickey responded that the question reflected the Board's preoccupation with the investment activities, and the Board could easily spend time on administrative matters. Ms. Ford added that other funds have also extended their educational sessions to include such things as a report from the actuary and a report from the fund attorney on topics like fiduciary responsibility. "So expanding past investments is a very wise idea because you do have other responsibilities."

Ms. Ghilarducci noted that PERF has not been politicized. ERISA funds have been politicized and budgets have been balanced by going after pension funds. There is one area where the Board can actually move ahead and make policy as Trustees by anticipating that the next time Indiana has a recession or a budget problem, this pot of money is going to look really attractive and the Trustees might not be able to fight off the politicians.

> I think we should move ahead and really be proactive in filling out our Investment Guidelines. The section dealing with the issue of economically targeted investments is currently empty. That extends into the issue of proxy voting which is clearly a value and an asset when you own equities, and the Board has no active policy with respect to that issue. I think we need to look at this education session not just as a catch up but also as a way to empower the Trustees to make real forward-looking policy.

Ms. Hamilton noted that through her capacity of working with the Teachers' Retirement Fund, the Governor's Office has encouraged the Trustees to undergo and seek out educational opportunities because this is a very critical juncture for the Fund. The Governor's Office wants people to feel that they are fully equipped with the information needed to make appropriate judgments.

9. ADMINISTRATIVE MATTERS

Building Manager Update

Mr. Dickey reported that PERF owns two buildings — 143 W. Market Street and 125 West Market Street. The 125 building is fully occupied, and the tenant is now paying rent. That tenant is the State's Year 2000 Project. With respect to the 143 building, there is a vacancy on the 3rd floor; however, it is PERF's intention to move the 7th floor tenants to that floor thereby freeing up a contiguous floor to PERF's 8th, 6th, and 5th floors. Such a move would allow for expansion. There are already some technology undertakings underway which will require space. Half of the 4th floor is vacant. Two existing tenants, both of whom are State agencies, are interested in that space. One of those tenants, the Department of Revenue, has been occupying the 2nd floor for a number of years with a team that's working on software development. They have been cited for fire code violations because they have too many people crammed on one floor, and they have no choice — they need the space available on 4 or they need for PERF to let them out of their lease.

Additionally, Mr. Dickey has been looking at the possibility of spending between $10,000 and $15,000 on restoring the 143 West Market Street building. The building was built in 1927 as a hotel. Before PERF's purchase of the property, an attempt was made to modernize the building by redoing the facade. He has had ongoing discussions through the building manager with some engineering firms to look at the possibility of restoring the facade and the lobby of the building to a 1920's appearance, the theory being that the building can never be turned into a class "A" building, but a lot can be done to maximize its location. There will be no commitment to spending money on a study about how to restore the building if, in fact, there's a high likelihood that it will cost $1 million to clean the facade and get back to the limestone underneath the sprayed on cement. When some assurance has been received that there is a good possibility that the job can be done for $100,000, $200,000, or whatever a reasonable number is in the opinion of the building manager, the green light will probably be given and a report made to the Board.

Annuity Investment Options

The law was changed last year on the annuity savings account portion of PERF's defined benefit plan. Beginning in July of 1998, the Fund needs to be prepared to give many more self-directed options to the members. As preparations begin to make these changes, one of the responsibilities placed on the Board is to set the investment options. Previously the Legislature determined the investment options, and there were only three: a bond fund, a guaranteed fund, and a money market fund. Under the new law, the guaranteed fund must be retained. It was Mr. Dickey's recommendation that the following investment options be preliminarily adopted as the range of options available to the members:

Large Cap S&P Index Fund
Small Cap Index Fund
Enhanced Large Cap Index Fund
Bond Fund
Money Market Fund
Guaranteed Fund (required by law)

By law, the members will have the right to set their asset allocation any time to take affect the beginning of the following fiscal quarter and that allocation, once made, cannot be changed for 12 months. While they have the flexibility to make a change, they can only do it once every twelve months and in increments of 10%.

Following discussion,

MOTION duly made by Nancy Turner, seconded by Steve Miller and unanimously carried to adopt the investment options as recommended by Mr. Dickey.

Quarterly Financial Report

Mr. Yeater reported that again this quarter the Fund had overspent in some areas of the budget and underspent in others. Two areas in which there was more spent than allotted included printing expenses and salaries for the use of temporary help. The Fund has tried to improve communications with its retirees by issuing a monthly message with the benefit checks, thereby incurring additional printing expenses.

Mr. Dickey noted that the Fund has traditionally been underbudgeted in the area of office equipment. During the last year big strides were made in terms of technological improvements, and the expense was augmented in the budget with the Budget Agency's approval and cooperation. This year there has been a technology budget built in. It is a positive variance at the moment. The negative variance is largely in the short-term temporary staff.

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Mr. Miller inquired if at year's end it is expected that the Fund will be somewhere near budget in total. Mr. Dickey responded that postage and freight expenses would probably end up high for the year. One of the biggest positive areas is salaries with a negative variance for temporary staff. There has long been a negative variance for temporary staff and a much higher positive variance in salaries because the budgeting process was very unrealistic. There were head count freezes, and the Fund could not hire the people for which the budget called. Thus, there was excess budget in those categories. In an effort to bring more reality to the budget process this last year, that money was trimmed back in cooperation with the Budget Agency, but there is still the negative variance for temporary staff.

10. Technology Update

Diann Clift was introduced as PERF's new Network Administrator. Ms. Clift has been in government since 1981 and has performed various tasks in programming and system analysis. She has been a Local Area Network Administrator, an Information Technology Director, and is currently a business consultant of Information Services Division.

In the time that she has been at PERF, she has set a goal for the Information Technology Department. Although technology is not needed in the agency, the whole concept of a department to handle this is new. So she is going to develop processes and implement technologies that will allow PERF to be proactive in assessing and meeting customer needs. Planned projects include:

Internet

- Benefits Calculator - Putting up a benefits calculator so members can get estimates on what retirement benefit they might receive. This feature should be implemented by the end of the year.
- Submission of Employer Data via Internet - House Bill 1945 was passed last session and allows for digitized signatures. That will authenticate information coming from employers. If that information can be received in an electronic form, it can then be put into the PERF system much more efficiently and with fewer errors.
- Bill Watch - Will allow staff to customize their tracking of bills which are submitted during a legislative session. They would tell the system that they want to look at only the bills which have to do with retirement, for example, and would be notified when there is activity with those bills thereby enabling the staff to be on top of all activity and make good decisions for the membership.
- Publish Inactive Members List - The Lieutenant Governor has requested that the Fund pursue notifying inactive members who are eligible for retirement or who have money in PERF and have not requested a refund. Those people are to be notified of the fact that they have money in the Fund and arrangements made to work out a benefit/refund of the money. (In many instances, an application for the funds was never made because the individuals may have died, and their families were not aware of their entitlement to a benefit/refund.) So, this will also be posted to the Internet, along with publication in various newspapers and broadcasting on radio and television stations.

Imaging

Currently, most of the documents in the files are available by physically going to the file. The goal is to make those available electronically. Not only does that provide security to the documents (it keeps them in a consistent place so that they are not misfiled), but it also minimizes error and also makes the documents much more available to staff.

Indiana Retirement Information System (IRIS)

- Annuity Options - The data base currently used will be accommodated to handle the new annuity options.
- Data Verification and Clean-up - Currently, the quality of the data in the system could be much better. That will be cleaned up so that there is good, accurate and complete data in order to make good business decisions.

Supportive Functions

These functions will be reviewed with respect to:

- Disaster Recovery - If anything happened to the building, what's going to happen to the data? Can the Fund recover from that and get back in business very quickly?
- Use of Technology - Is the technology being used as efficiently as possible?
- Security/Audit Procedures - Documentation of those procedures and making sure there are good procedures in place.
- User and System Documentation - To enable new staff to be brought on board and trained very quickly thereby supporting the business functions of the Fund.

11. NEW UNITS & ENLARGEMENTS

MOTION duly made by Dwayne Isaacs, seconded by Nancy Turner and unanimously carried to approve the following new units and enlargements:

New Units

1669	-	Town of Whiteland
1670	-	Danville-Center Township Public Library
1671	-	Town of Burlington
1672	-	Sheridan Public Library
1673	-	Town of Crothersville
1674	-	Town of Grandview
1675	-	Lake Lemon Conservancy District
1676	-	Lincoln Heritage Public Library
1677	-	Worthington-Jefferson Township Public Library
1678	-	Town of Carbon
1679	-	Town of Clarks Hill
1680	-	Spencer Township

Enlargements

480	-	Michigan City Area Schools
516	-	North Madison County Public Library
653	-	Rochester Community School Corp.
687	-	City of Whiting
884	-	Garrett Public Library
918	-	MSD Wabash County
919	-	Greene County
1017	-	Putnam County
1041	-	City of Lawrence
1107	-	Adams County
1285	-	Big Blue River Conservancy District
1344	-	City of Butler
1409	-	City of Martinsville
1459	-	Tell City-Perry County Public Library
1503	-	South Putnam Community School Corp.
1514	-	Springs Valley Community Schools
1518	-	MSD of Shakamack
1529	-	Town of Advance
1531	-	Town of Merrillville
1532	-	Connersville Utilities
1535	-	Pike County School Corporation
1549	-	Clay Community School Corp.
1555	-	Porter County Education Interlocal
1605	-	Pike County Public Library
1637	-	Porter County Solid Waste Management District
1640	-	Town of Bristol
1650	-	Town of Carlisle
1651	-	Central Indiana Educational Service Center

12. NEXT MEETING DATE

By common consent, the next meeting of the Board was set for February 23 and 24, 1998.

13. ADJOURNMENT

There being no further business, a Motion to adjourn was entertained, and by unanimous vote, the meeting was adjourned.

Richard T. Doermer Chairman	H. Garth Dickey Director